FILED
OCT 3 1958
JAMES R. BROWNING, Cle

IN THE

Supreme Court of the United States

October Term, 1958.

No. 416.

ROSAMOND UNDERWOOD SMITH WILSON, THOMAS W. SMITH and FRANK STAPLETON, as Executors of the Estate of COTHRAN P. SMITH, Deceased,

Petitioners,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

GEORGE R. FEARON,
Counsel for Petitioners,
306 University Building,
Syracuse, N. Y.

COSTELLO, COONEY & FEARON,
Of Counsel,
306 University Building,
Syracuse, N. Y.

THE REPORTER COMPANY, INC., Walton, N. Y.—1958

Index.

	Page
Opinions Below	1
Jurisdiction	1
Questions Presented	2
Statutes, Federal Rules, and Regulations Involved	3
Statement	3
Reasons for Granting the Writ	5
Conclusion	12
Appendix	13
Opinion of Court Below	13
Judgment	19
Amendment V—Constitution of the United States	21
Section 209(a)—Revenue Act of 1950	21

CITATIONS.

CASES:

	Page
Commissioner of Internal Revenue v. Babson, 7 Cir., 70 F. 2d 304, cert. den. 1934, 293 U. S. 571	5, 7
Commissioner of Internal Revenue v. Roberts, 4 Cir., 1953, 203 F. 2d 304	5
Commissioner of Internal Revenue v. Sullivan, 5 Cir., 1954, 210 F. 2d 607	5
Ferro v. Commissioner of Internal Revenue, 3 Cir., 1957, 242 F. 2d 838	5, 8
Hirsch v. Commissioner of Internal Revenue, 9 Cir., 1941, 124 F. 2d 24	5
Hyman v. Helvering, 63 App. D. C. 221, 71 F. 2d 342, cert. den. 1934, 293 U. S. 570	5
Jacob v. New York City, 315 U. S. 752	6
Jones v. Dawson, 10 Cir., 1945, 148 F. 2d 87	5
Jones v. Griffin, 10 Cir., 1954, 216 F. 2d 885	5
Keefe v. Cote, 1 Cir., 1954, 213 F. 2d 651	5, 7
Kirschenbaum v. Commissioner of Internal Revenue, 2 Cir., 155 F. 2d 23, cert. den., 1946, 329 U. S. 726	5
Nectow v. City of Cambridge, 277 U. S. 183	10
Northup v. U. S., 2 Cir., 240 F. 2d 304	5, 6, 8
Randolph v. Commissioner of Internal Revenue, 8 Cir., 76 F. 2d 472, cert. den., Helvering v. Randolph, 1935, 296 U. S. 599	5, 7
Rogers v. Missouri Pacific R. R. Co., 352 U. S. 500	6
United States v. Fewell, 5 Cir., 1958, 255 F. 2d 496	5, 8
Woodworth v. Commissioner of Internal Revenue, 6 Cir., 1955, 218 F. 2d 719	5, 8

STATUTES:

	Page
Amendment V, U. S. Constitution	3
Internal Revenue Code of 1939	
Section 22 (53 Stat. 7, 26 U. S. C. [1952 Ed.], §22)	3
Section 115 (53 Stat. 46, 26 U. S. C. [1952 Ed.], §115)	3
Revenue Act of 1950	
Section 209(a) (64 Stat. 931, 932)	10

MISCELLANEOUS:

Committee Report, House of Representatives, Revenue Act of 1926 (H. R. Rep. No. 1, 69th Cong., 1st Sess. 5 [1926])	9

IN THE

Supreme Court of the United States

October Term, 1958.

No.

ROSAMOND UNDERWOOD SMITH WILSON, THOMAS W. SMITH and FRANK STAPLETON, as Executors of the Estate of Cothran P. Smith, Deceased,
Petitioners,

vs.

THE UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above case on July 11, 1958.

Opinions Below.

The opinion of the District Court for the Northern District of New York (R. p. 96a) is reported at 154 F. Supp. 341. The opinion of the Court of Appeals for the Second Circuit (R. p. 104a) is reported at 2 A. F. T. R. (2d) 5292.

Jurisdiction.

The judgment of the Court of Appeals for the Second Circuit was made and entered on July 11, 1958, and a

copy thereof is appended to this petition in the Appendix at page 19. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

Questions Presented.

In this action to recover moneys paid pursuant to an assessment of additional income tax claimed to be erroneous and illegal, petitioners duly filed and served a demand for jury trial (R. p. 7a). Upon the trial, after the jury had heard the evidence of both parties, the District Court reserved decision on the motions for directed verdict and discharged the jury. Subsequently, the District Court filed its opinion (R. p. 96a) holding that the ultimate question, namely, whether the purchase by a closely held corporation of 200 shares of its own capital stock from one of its principal stockholders, constitutes a distribution "essentially equivalent to the distribution of a taxable dividend," is a question of law rather than a question of fact. The District Court thereupon granted respondent's motion for a directed verdict. The Court of Appeals affirmed.

The questions presented here are:

1. Is it not a question of fact for the jury to determine whether a cancellation or redemption of a corporation's capital stock from one of its principal stockholders amounts to a "distribution essentially equivalent to a taxable dividend"?

2. Whether Congress, in enacting Section 115 (g) of the Internal Revenue Code of 1939, intended to tax as ordinary income, the proceeds of the conversion of a portion of a decedent's assets into cash by the executors of his estate in order to pay the estate taxes imposed thereon.

3. Whether, if so interpreted, such statute is not unconstitutional and void as depriving petitioners of their

property without due process of law, in contravention of the Fifth Amendment to the Constitution of the United States.

Statutes, Federal Rules and Regulations Involved.

The pertinent portions of the Internal Revenue Code of 1939, namely, Section 22 (53 Stat., p. 7, 26 U. S. C., 1952 ed., Section 22) and Section 115 (53 Stat., p. 46, 26 U. S. C., 1952 ed., Section 115), are set forth in the Appendix at pages 14 and 15. The pertinent portion of the Fifth Amendment to the Constitution of the United States is set forth in the Appendix at page 21.

Statement.

This action, pursuant to Section 1346 (a) (1) of Title 28 of the United States Code, is to recover internal revenue taxes and interest thereon, totalling $47,848.80, which plaintiffs paid to the United States pursuant to an assessment of additional income tax claimed to be erroneous and illegal. A demand for jury trial was duly filed herein and copies were duly served.

At the close of the evidence the District Court discharged the jury and reserved decision on the motions of the respective parties. Thereafter the District Court rendered its decision dismissing the complaint and granting defendant's motion for a directed verdict. This decision has been affirmed by the United States Court of Appeals for the Second Circuit.

The income tax assessment in question arose as the result of a transaction in December of 1949 in which petitioners, as executors of the estate of Cothran P. Smith, sold to the Addis Co., Inc., a corporation of which the decedent, Cothran P. Smith, held 2,480 of 2,500 outstand-

ing common shares, 200 of those shares for a total consideration of $57,200. Petitioners maintain this was no more than an ordinary sale of certain assets at a reasonable price in order to pay the estate taxes assessed upon them by reason, principally, of the decedent's large holdings in this corporation. Respondent claims the transaction is a "distribution essentially equivalent to the distribution of a taxable dividend" within the meaning of Section 115 (g) of the Internal Revenue Code of 1939. Petitioners have paid the additional assessment in full and seek its recovery in this action.

On the trial, petitioner, Thomas W. Smith, testified fully concerning this transaction, the circumstances and motives leading up to it (R. pp. 23a to 55a). His testimony may be summarized: As one of the executors he was faced with the necessity of paying more than $200,000 in estate taxes. The assets of the estate consisted of stock in the Addis Co., Inc., valued for estate tax purposes at $868,000, and all other assets valued at $159,940.53. Most of the latter were needed to pay debts or were otherwise specifically bequeathed. To obtain the difference between the cash available and the taxes to be paid, the executors sold the shares in question to the corporation.

Respondent did not show that there was a market or other buyer for this nor did respondent contest the testimony of petitioners' witnesses as to the facts. Relying on this lack of dispute as to the facts (R. pp. 73a to 78a) the District Court determined that no question of fact existed to be presented to the jury and specifically held that the ultimate question of whether or not there was a distribution which was substantially equivalent to the distribution of a taxable dividend was one of law rather than of fact. In so doing the District Court held that reasonable men could not reach a different conclusion in the absence of a dispute as to what had taken place.

Reasons for Granting the Writ.

The decision herein of the courts below involves a direct conflict with decisions of the Court of Appeals in the First, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and Tenth Circuits and of the Court of Appeals for the District of Columbia (*Hyman v. Helvering,* 63 App. D. C. 221, 71 F. 2d 342, 345, certiorari denied, 1934, 293 U. S. 570, 55 S. Ct. 100, 79 L. Ed. 669; *Keefe v. Cote,* 1 Cir., 1954, 213 F. 2d 651, 656; *Ferro v. Commissioner of Internal Revenue,* 3 Cir., 1957, 242 F. 2d 838, 841; *Commissioner of Internal Revenue v. Roberts,* 4 Cir., 1953, 203 F. 2d 304, 307; *United States v. Fewell,* 5 Cir., 1958, 255 F. 2d 496, 499; *Commissioner of Internal Revenue v. Sullivan,* 5 Cir., 1954, 210 F. 2d 607, 609; *Woodworth v. Commissioner of Internal Revenue,* 6 Cir., 1955, 218 F. 2d 719, 724; *Commissioner of Internal Revenue v. Babson,* 7 Cir., 70 F. 2d 304, 306, certiorari denied, 1934, 293 U. S. 571, 55 S. Ct. 107, 79 L. Ed. 669; *Randolph v. Commissioner of Internal Revenue,* 8 Cir., 76 F. 2d 472, 476, certiorari denied, *Helvering v. Randolph,* 1935, 296 U. S. 599, 56 S. Ct. 116, 80 L. Ed. 425; *Hirsch v. Commissioner of Internal Revenue,* 9 Cir., 1941, 124 F. 2d 24, 28; *Jones v. Dawson,* 10 Cir., 1945, 148 F. 2d 87, 90; *Jones v. Griffin,* 10 Cir., 1954, 216 F. 2d 885, 887).

The point of conflict is whether the determination of the essential equivalence of a corporate distribution to the distribution of a taxable dividend is a question of fact or one of law. The Court of Appeals for the Second Circuit has held, in *Northup v. U. S.,* 240 F. 2d 304, and again in the instant case, that the question is one of law. The other ten circuits have held to the contrary.

In fact, this holding on the part of the Second Circuit is an apparent conflict with its own earlier decision in *Kirschenbaum v. Commissioner of Internal Revenue,* 2

Cir., 155 F. 2d 23, 24, certiorari denied, 1946, 329 U. S. 726, wherein the Court stated that the issue of dividend equivalence did not raise any questions susceptible of review.

Basing its ruling on the *Northup* case, *supra*, the District Court refused to submit this question to the jury, terming it a "nightmarish problem" (R. p. 96a). Is it not, however, just such "nightmarish" problems that juries are expected to resolve under our system? Can we say that the tax statutes, by which all citizens, and petitioners as executors, are expected to abide are beyond the comprehension of the ordinary juryman, a so-called "reasonable man"? Is not the ordinary man's concept of dividend equivalence exactly what we are trying to reach? Where, in the statute, is the expression of Congressional intent that this question should be left to the Trial Judge to the exclusion of the jury?

Mr. Justice Murphy speaking for this court, in *Jacob v. New York City*, 315 U. S. 752, said:

> "The right of jury trial in civil cases at common law is a basic and fundamental feature of our system of federal jurisprudence, which is protected by the Seventh Amendment. A right so fundamental and sacred to the citizen, whether guaranteed by the constitution or provided by statute, should be jealously guarded by the courts."

This court has recently probed this problem in *Rogers v. Missouri Pacific Railroad Co.*, 352 U. S. 500, and related cases involving the Federal Employers Liability Act. In those cases, the majority of this court, reaffirmed its policy of examining the evidence where necessary in order to assure a party that his right to a jury verdict was not improperly abridged by the Trial Court.

In holding dividend equivalence to be a jury question several of the courts of appeal have, over a span of many years, stated their opinions thus:

Commissioner of Internal Revenue v. Babson, 7 Cir., 70 F. 2d 304, 306, certiorari denied, 1934, 293 U. S. 571, 55 S. Ct. 107, 79 L. Ed. 669:

> "It is contended by petitioner, however, that the issue just stated is one of law and not of fact. * * * In other words, he insists that unless the distribution is a part of a complete liquidation, it must be held to be an ordinary taxable dividend. We do not conceive this to be the meaning of the statute, and we think our conclusion in this respect is supported by Treasury Regulation 69, Article 1549, which in substance states that the question is one of fact dependent upon the circumstances in each case."

Randolph v. Commissioner of Internal Revenue, 8 Cir., 76 F. 2d 472, 476, certiorari denied:

> "The question as to whether a distribution in connection with the cancellation or redemption of stock is essentially equivalent to a distribution of a taxable dividend is one of fact dependent upon the circumstances of each case. *Commissioner v. Babson* (C. C. A. 7), 70 F. 2d 304, 306, 307. The determination of the Board of Tax Appeals of a question of fact will not be examined by this court beyond ascertaining whether its finding is sustained by substantial evidence."

Keefe v. Cote, 1 Cir., 1954, 213 F. 2d 651, 656:

> "The determinative question is whther the payment here involved was 'essentially equivalent' to the distribution of a 'taxable dividend' as defined in Section 115(a). Thus Section 115(g) requires a factual comparison of the particular distribution in question with distributions which are dividends under Section 115(a) as distinguished from distributions under Section 115(c) in either complete or

partial liquidation as defined in Section 115(i). This obviously poses a question of fact, as the cases unanimously hold and the applicable Treasury Regulation quoted in material part in the margin clearly recognizes. * * *"

Woodworth v. Commissioner of Internal Revenue, 6 Cir., 1955, 218 F. 2d 719, 724:

> "The Tax Court's finding of substantial equivalence to a dividend, although decisive of the sole ultimate issue, remains a finding of fact."

Ferro v. Commissioner of Internal Revenue, 3 Cir., 1957, 242 F. 2d 838, 841:

> "We have always held that the issue of whether corporate distribution was essentially equivalent to a taxable dividend was a question of fact to be determined by the Tax Court, and reviewable by us only to the extent of ascertaining whether substantial evidence exists in the record to support that determination and that the determination was made upon the application of the correct criteria. * * * The other circuits are practically in unanimous accord."

United States v. Fewell, 5 Cir., 1958, 255 F. 2d 496, 499:

> "The question whether or not a particular corporate transaction is essentially equivalent to the distribution of a taxable dividend is primarily a question of fact. * * * It is the settled law that although the facts may be undisputed, if reasonable men might draw different conclusions from them the case is for the jury."

Against this array of judicial authority, the Court of Appeals for the Second Circuit stands alone in its opinion set forth in *Northup v. United States*, 240 F. 2d 304, 307, and reaffirmed in its decision in the instant case:

> "We think the question whether a partial liquidation is 'essentially equivalent' to a dividend, involving as it does the application of a statutory rule

> to found facts, is a question of law and that we are not so limited in our review. This is precisely the kind of question it is our function to decide."

It is further submitted that the statutory standard herein involved, namely, a "distribution substantially equivalent to the distribution of a taxable dividend" is in itself, vague and nebulous. Through the years following its original enactment in the Revenue Act of 1926, its scope and application has been extended far beyond the situation for which the Congress originally designed it. Its purpose was explained in the Committee report (H. R. Rep. No. 1, 69th Cong., 1st Sess. 5 (1926), as follows:

> "It has been contended that under existing law a corporation especially one which has only a few stockholders, might be able to make a distribution to its stockholders which would have the same effect as a taxable dividend. For example: Assume that two men hold practically all the stock in a corporation, for which each had paid $50,000 in cash, and the corporation had accumulated a surplus of $50,000 above its cash capital. It is claimed that under existing law the corporation could buy from the stockholders, for cash, one-half of the stock held by them and cancel it without making the stockholders subject to any tax. Yet this action, in all essentials, would be the equivalent of a distribution through cash dividends of the earned surplus. The amendment proposed to this subdivision is intended to make it clear that such a transaction is taxable."

Designed as protection from the plans of scheming taxpayers to evade taxes by capitalizing profits and liquidating the capital so created, it has been distorted into a severe penalty for many innocent law-abiding taxpayers desiring and often being forced by the tax laws to liquidate a portion of their justly acquired assets.

The arbitrary and unequal result of the lower Court's holding is illustrated by the fact that a stockholder in a

listed corporation is not so penalized although the appreciated value of his stock is undoubtedly the result of retained earnings and profit. He can readily convert his stock into cash for the payment of inheritance taxes without incurring this penalty. Why should the shareholder in a small corporation be treated differently? Surely Congress did not intend that he should be.

The statute was devised to prevent the successful execution of a tax evasion scheme. That it was never intended to prevent an executor from realizing sufficient funds from a family corporation's stock to pay administration expenses and death taxes, is evidenced by the 1950 amendment specifically exempting such transactions thereafter (Act of September 23, 1950, Section 209[a], 64 Stat. 931, 932).

Only timely intervention by this Court can resolve the dilemma created by the vague and illusory language of Section 115(g) and the varying judicial interpretations thereof.

This Court has held that a statute may be unconstitutional in its application to a particular set of facts, even though it is not otherwise objectionable (*Nectow v. City of Cambridge,* 277 U. S. 183). Petitioners submit that such a situation is presented here. As interpreted and as applied to them, Section 115(g) of the Internal Revenue Code of 1939, deprives them of their property without due process of law in contravention of the Fifth Amendment of the Constitution of the United States, and it is therefore, unconstitutional and void.

Petitioners engaged in neither artifice nor fraud. They did not try to evade the tax. Tax considerations entered into the transaction only insofar as it was necessary to convert a portion of a given asset into an amount of cash required for the payment of inheritance taxes, and

in the light of their fiduciary duties, to be accomplished without destroying the asset in the process.

To have distributed all of the cash in the corporation (some $175,000) by way of dividends would have made available only slightly more than $56,000 of the $225,000 necessary to pay the death taxes alone. Conversely, to have obtained the entire amount necessary for payment of the death taxes through the declaration of dividends would have required a dividend in that year, 1949, of $976,252.17, a sum almost equal to the total net asset value of the corporation of $1,029,000.

It is a far cry from the evasive practices denounced by Congress at the time this statute was first enacted to the situation presented here. Yet, that is in fact the extent to which its scope has been enlarged.

As so enlarged and applied, petitioners contend this statute is unconstitutional and void as depriving them and others similarly situated, of their property without due process of law.

The questions presented by this case are of great and recurring significance in the administration of the increasingly important tax laws of the United States. The serious question of depriving a taxpayer of his right to a jury verdict on the question of dividend equivalence, and the further questions of the effect of the decision herein upon fiduciaries entrusted with the preservation and administration of a decedent's estate as specifically presented herein, make this case an especially appropriate one for the exercise of this Court's discretionary jurisdiction.

CONCLUSION.

For the reasons set forth above it is respectfully submitted that this petition for a writ of certiorari should be granted.

GEORGE R. FEARON,
Counsel for Petitioners,
306 University Building,
Syracuse, New York.

COSTELLO, COONEY & FEARON,
Of Counsel for Petitioners,
306 University Building,
Syracuse, New York.

APPENDIX.

Opinion of Court Below.

Before: Waterman and Moore, Circuit Judges, and Galston, District Judge.

Appeal from the United States District Court for the Northern District of New York, James T. Foley, Judge.

Rosamond Underwood Smith Wilson, Thomas W. Smith and Frank Stapleton, executors of the Estate of Cothran P. Smith, appeal from the dismissal (154 F. Supp. 341) of their action against the United States of America for refund of income taxes paid by the estate, and from an order denying their motion for a directed verdict and granting the defendant's motion for a directed verdict Affirmed.

GALSTON, District Judge:

The taxpayers, as executors of an estate, appeal from an order of the District Court for the Northern District of New York dated September 18, 1957, dismissing their complaint in which they asked for a partial refund of the 1949 income tax paid by the estate.

Plaintiffs were duly appointed executors of the estate of Cothran P. Smith on January 12, 1949. Decedent's estate was valued at $1,027,940.53, and was made up principally of decedent's common stock holdings in the Addis Co., Inc., consisting of 2,480 shares of common stock valued at $868,000. There were 2,500 shares of said stock outstanding at the time of Smith's death. Smith's wife held 10 shares and a nephew who worked in the store held the remaining 10 shares. In 1949 the executors sold 200 shares of said stock to the Addis Co., Inc., for $57,200. The transaction was arranged by the taxpayers who acted both as directors of the company and as executors of the estate. The corporate resolution re-

cited that the stock acquired from the estate should be held in the corporate treasury and not be cancelled or redeemed. The said 200 shares so purchased by the company are still carried on the corporate books as treasury stock.

On its income tax return for 1949 the estate reported a capital gain of $43 as the result of the sale of said stock by the estate to the Addis Co., Inc. The Commissioner ruled that the $57,200 received by the estate was a distribution essentially equivalent to a dividend and was taxable at ordinary income rates, inasmuch as the company had earnings or profits of approximately $657,000. As a consequence, the Commissioner determined a deficiency of $40,103.82, which the estate later paid together with interest. The executors brought this suit to recover the total payment of $47,848.80.

The District Court dismissed the complaint without submitting the case to the jury, holding that the distribution of $57,200 to the majority stockholders was essentially equivalent to a dividend under Section 115 (g) of the 1939 Internal Revenue Code.[1]

---

[1] Internal Revenue Code of 1939:

Sec. 22. Gross Income.

(a) General Definition—"Gross income" includes gains, profits, and income derived from * * * dividends * * *

(26 U.S.C. 1952 ed., Sec. 22.)

Sec. 115. Distribution by Corporations.

(a) Definition of Dividend.—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) Source of Distribution.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

(c) [as amended by Section 147, Revenue Act of 1942, c. 619, 56 Stat. 798] Distribution in Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation

Appellants contend that since the stock was held as treasury stock by the corporation there was no cancellation or redemption within the meaning of Section 115 (g), and cite, in support of this proposition, *Alpers v. Commissioner* (C. A. 2d 1942), 126 F. 2d 58, and *Commissioner v. Snite* (C. A. 7 1949), 177 F. 2d 819.

In *Alpers v. Commissioner (supra)*, the majority of this court, in determining under the factual situation in that case that the stock was not acquired for "purposes of cancellation," indicated that they made the following assumption:

> "In any event the respondent has made no contention that the distinction between retired stock and treasury stock is not justified by the statute, and we shall assume that it is."

Thereafter this court, in *Kirschenbaum v. Commissioner* (C. A. 2d 1946), 155 F. 2d 23, cert. den'd 329 U. S. 726, cast some doubt on the previous ruling stating:

> "The status of 'treasury shares' is in general not made perfectly clear in the books. Some courts

---

of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

(g) Redemption of Stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * * * *

(i) Definition of Partial Liquidation.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. (26 U.S.C. 1952 ed., Sec. 115.)

> treat them as though they were, so to say, in suspended animation—existing, but existing only in a kind of Limbo; other courts treat them as though they were retired. Whether they are to be treated as one or the other in the Internal Revenue Code, in not a priori wholly free from debate."

In *Commissioner v. Snite (supra)*, stock was purchased by the corporation under a plan whereby it would be later resold to employees of the corporation. It was held that there was no cancellation or redemption.

In *Wall v. United States* (C. A. 4th 1947), 164 F. 2d 462, the Court stated:

> "We have no difficulty in reaching the conclusion in this case that the shares were redeemed in the statutory sense. * * * If it should be held that taxpayers can avoid the terms of the statute by the simple device of selling their stock to the corporation and having it held as treasury stock, the purpose of the statute to prevent the evasion of taxes upon corporate dividends would be completely frustrated."

Succeeding cases have reached the conclusion that there is no distinction under Section 115(g) between stock cancelled and retired and stock purchased but held by the corporation as treasury stock without any plan or intention of reissuance. *Boyle v. Commissioner* (C. A. 3d 1951), 187 F. 2d 557, cert. den'd 342 U. S. 817; *Keefe v. Cote* (C. A. 1st 1954), 213 F. 2d 651; *Earle v. Woodlaw* (C. A. 9th 1957), 245 F. 2d 119, cert. den'd 354 U. S. 942.

In the instant case, when the corporation acquired the certificates of stock it had no definite plans for creating new stock obligations, and the said stock certificates are still in the corporate treasury. Clearly, by the simple expedient of holding the acquired stock in the corporation's treasury rather than retiring it, a taxpayer can-

not obtain immunity from the operation of Section 115(g) of the Internal Revenue Code. Of course, where shares are purchased by a corporation under a plan to resell them, there is no cancellation or redemption within the meaning of Section 115(g). But that state of facts does not exist in the case at bar.

Appellants next assert that there was a change in the proportionate ownership of the corporation by the various stockholders caused by the sale of the 200 shares of stock, and hence the distribution was not essentially equivalent to a taxable dividend. Prior to decedent's death he owned 2480 shares of common stock out of 2500 shares oustanding. His wife owned 10 shares and his nephew the remaining 10. Under the decedent's will 15% of his common stockholdings were specifically bequeathed to his wife and 15% to his nephew; the remaining 70% passing under the residuary clause of the will to a trust for the benefit of his son. Therefore, after decedent's death and before the sale to the corporation, the beneficial stockholdings were 382 shares each for the wife and nephew (15.28% each), and 1736 shares for the residuary trust for the benefit of the son (69.44%). After the sale, the beneficial interest changed in that the residuary trust held 200 less shares, so that the proportionate interests in the outstanding stock became 16.61% each for the wife and the nephew, and 66.78% for the residuary trust. Appellants claim that this change in the ratio of ownership is so great as to show that the distribution was not essentially equivalent to a taxable dividend.

However, even considering the beneficial interests of the legatees, we cannot conclude that the distribution resulted in any substantial change in ownership or control of the corporation. In addition there was no decrease, shrinkage or contraction in the business activities of the corporation. The transactions were carried out

so that the executors of the estate would have the required funds to pay the estate tax. Furthermore, there is no dispute that large corporate earnings and profits were available and were in fact used for the distribution. The record shows that for at least six years before the stock purchase the corporation, in spite of large earnings, had paid no dividend on its common stock. See *Boyle v. Commissioner (supra)*; *Ferro v. Commissioner* (C. A. 3d 1957), 242 F. 2d 838.

From an examination of the transaction as a whole, we reached the conclusion that no "different results were produced by what was in form a partial liquidation from the results that would have been produced, under the circumstances, by a dividend." *Northup v. United States* (C. A. 2d 1957), 240 F. 2d 304.

Finally, appellants contend that the Trial Court was in error in not submitting this case to the jury. It appears clearly that there was no dispute concerning the operative facts. As this Court stated in *Northup v. United States (supra)*:

> "We think the question whether a partial liquidation is 'essentially equivalent' to a dividend, involving as it does the application of a statutory rule to found facts, is a question of law. * * *"

The order is affirmed.

Judgment.

UNITED STATES COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the eleventh day of July, one thousand nine hundred and fifty-eight.

Present:

Hon. Sterry R. Waterman
Hon. Leonard P. Moore
Circuit Judges
Hon. Clarence G. Galston
District Judge

ROSAMOND UNDERWOOD SMITH WILSON, THOMAS W. SMITH and FRANK J. STAPLETON as executors of the Estate of Cothran P. Smith, deceased,
Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Northern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Northern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

A. DANIEL FUSARO
Clerk

Amendment V—Constitution of the United States.

"No person shall be * * * nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

Section 209(a)—Revenue Act of 1950.

"(a) Certain distributions not treated as dividends. Section 115 (g) (relating to redemptions of stock) is hereby amended by adding at the end thereof the following:

(3) Redemption of stock to pay death taxes. The provisions of this subsection shall not apply to such part of any amount so distributed with respect to stock the value of which is included in determining the value of the gross estate of a decedent in accordance with Section 811, as is distributed after such decedent's death and within the period of limitations for the assessment of estate tax provided in Section 874 (a) (determined without the application of Section 875) or within 90 days after the expiration of such period, and as is not in excess of the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of such decedent's death: *Provided*, That the value of the stock in such corporation for estate tax purposes comprises more than 50 per centum of the value of the net estate of such decedent."

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	4
Argument	5
Conclusion	9

CITATIONS

Cases:	
Commissioner v. *Roberts*, 203 F. 2d 304	8
Earle v. *Woodlaw*, 245 F. 2d 119, certiorari denied, 354 U. S. 942	7, 9
Ferro v. *Commissioner*, 242 F. 2d 838	9
Flanagan v. *Helvering*, 116 F. 2d 937	6
Helvering v. *Wood*, 309 U. S. 344	6
Jones v. *Griffin*, 216 F. 2d 885	9
Keefe v. *Cote*, 213 F. 2d 651	9
McCray v. *United States*, 195 U. S. 27	7
United States v. *Fewell*, 255 F. 2d 496	7, 9
Statutes:	
Internal Revenue Code of 1939:	
Sec. 22 (a) (26 U. S. C. 1952 ed., Sec. 22 (a))	2
Sec. 115 (a) (26 U. S. C. 1952 ed., Sec. 115 (a))	2
Sec. 115 (b) (26 U. S. C. 1952 ed., Sec. 115 (b))	3
Sec. 115 (c) (26 U. S. C. 1952 ed., Sec. 115 (c))	3
Sec. 115 (g) (26 U. S. C. 1952 ed., Sec. 115 (g))	3, 6, 7, 9
Sec. 115 (i) (26 U. S. C. 1952 ed., Sec. 115 (i))	4
Sec. 117	7
Internal Revenue Code of 1954:	
Sec. 302 (26 U. S. C. 1952 ed. Supp. V, Sec. 302)	6
Sec. 303 (26 U. S. C. 1952 ed. Supp. V, Sec. 303)	6
Revenue Act of 1950, c. 994, 64 Stat. 906, Sec. 209 (a) (26 U. S. C. 1952 ed., Sec. 115 (g))	6
Miscellaneous:	
H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 90–91 (1950–2 Cum. Bull. 380)	6
S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 82–83 (1950–2 Cum. Bull. 483)	6

In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 416

ROSAMUND UNDERWOOD SMITH WILSON, THOMAS W. SMITH AND FRANK STAPLETON, AS EXECUTORS OF THE ESTATE OF COTHRAN P. SMITH, DECEASED, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 96a–102a)[1] is reported in 154 F. Supp. 341. The opinion of the Court of Appeals (Pet. 13–18) is reported in 257 F. 2d 534.

JURISDICTION

The judgment of the Court of Appeals was entered on July 11, 1958. (Pet. 19). The petition for writ of certiorari was filed on October 3, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

[1] Record references are to the appendix to taxpayers' brief in the Court of Appeals.

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the District Court's determination, on the basis of the undisputed facts and upon motions of both parties for a directed verdict, that a corporate distribution of earnings in redemption of some of the stock held by the controlling stockholder (an estate), for the avowed purpose of providing funds for the payment of estate taxes owed by the distributee-stockholder, was essentially equivalent to the distribution of a taxable dividend under Section 115 (g) of the Internal Revenue Code of 1939.

STATUTES INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dividends * * *.
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 22.)
>
> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

(c) [amended by Section 147, Revenue Act of 1942, c. 619, 56 Stat. 798] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated

after February 28, 1913, shall be treated as a taxable dividend.

* * * * *

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U. S. C. 1952 ed., Sec. 115.)

STATEMENT

The taxpayers are the duly qualified executors of the estate of Cothran P. Smith who died on December 26, 1948. (Pet. 13; R. 3a, 5a.)

Smith was the managing director of the Addis Co., Inc., and at the time of his death he owned 2,480 of the 2,500 shares of outstanding Addis Company stock. (Pet. 13; R. 27a.) The remaining 20 shares were owned by his wife and one of his nephews. (Pet. 13; R. 98a–99a.) In his will, Smith left 15% of his stock to his wife, 15% to his nephew, and the remaining 70% to a residual trust for the benefit of his wife and son. (Pet. 17; R. 89a–91a.)

For estate tax purposes, Smith's stock was valued at $868,000 and his entire estate was valued at approximately $1,025,000. (Pet. 13; R. 5a.) His executors were required to pay estate and inheritance taxes totalling approximately $225,000. (R. 5a.)

In 1949, the Addis Company acquired 200 shares of its stock from the Smith estate for $57,200. (Pet. 13; R. 26a.) The transaction was arranged by the tax-

payers who were acting in a dual capacity as directors of the company and executors of the estate. (Pet. 13; R. 23a, 28a.) Pursuant to a corporate resolution, the 200 shares which the company acquired from the estate were carried on the corporate books as treasury stock. (Pet. 13–14; R. 32a.)

On its income tax return for 1949, the estate treated the above transaction as a liquidation distribution giving rise to a capital gain of $43. However, the Commissioner ruled that the $57,200 received by the estate was essentially equivalent to a dividend and was taxable at ordinary income rates, inasmuch as the company had earnings or profits of approximately $657,000. Taxpayers paid the deficiency determined by the Commissioner and thereafter brought refund suit to recover the total payments of $47,848.80. (Pet. 14; R. 3a–4a.)

At the conclusion of the trial, both sides moved for a directed verdict. (R. 71a, 97a.) The District Court granted the Government's motion and denied that of the taxpayers. (R. 102a.) Accordingly, the District Court dismissed the complaint without submitting the case to the jury, holding that the corporation had redeemed its stock and that the simultaneous distribution of $57,200 to the estate as majority stockholder was essentially equivalent to a dividend under Section 115 (g) of the Internal Revenue Code of 1939. (R. 96a–102a.) In an unanimous opinion, the Court of Appeals affirmed this ruling. (Pet. 13–18.)

ARGUMENT

The decision below is correct, the asserted conflict with other decisions does not exist, and the case has

limited significance since it deals with a problem resolved by subsequent legislation.

1. In their petition, taxpayers now assert for the first time that Section 115 (g) of the 1939 Code, *supra*, pp. 3–4, has no application whatsoever to this case (Pet. 9–10), and that if the section were applicable, it would be unconstitutional as applied to them (Pet. 11). Since these contentions were not urged below, they should not be considered now (*Helvering* v. *Wood*, 309 U. S. 344, 348–349), and in any event, the contentions are clearly without merit.

Contrary to taxpayers' assertions (Pet. 9–10), a distribution in redemption of stock can be taxed as a dividend under the applicable provisions of Section 115 (g), regardless of the fact that the purpose of the distribution was to supply funds for the payment of estate and inheritance taxes levied on the estate of a deceased stockholder. *Flanagan* v. *Helvering*, 116 F. 2d 937 (C. A. D. C.). In 1950, after the distribution in question here had taken place, Congress amended Section 115 (g) by stating that "The provisions of this subsection shall not apply" to distributions used to pay estate taxes under certain limited and specified circumstances. Sec. 209 (a), Revenue Act of 1950, c. 994, 64 Stat. 906. This amendment is clearly a relief measure which changes the pre-existing law rather than restating it as suggested by the taxpayers. See S. Rep. No. 2375, 81st Cong., 2d Sess. pp. 82–83 (1950–2 Cum. Bull. 483, 542); H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 90–91 (1950–2 Cum. Bull. 380, 445). See also Sections 302 and 303 of the Internal Revenue Code of 1954.

Taxpayers' argument that the application of Section 115 (g) is unconstitutional as applied to them appears to be based solely on the fact that they are required by the taxing statute to pay a higher tax than they would like. (See Pet. 10–11.)[2] The fact that a particular tax works a hardship clearly does not mean that the tax is unconstitutional. *McCray* v. *United States,* 195 U. S. 27, 57–58, 60–61.

2. Taxpayers' remaining argument, which was urged below, relates to the fact that the District Court decided this case without submitting it to the jury. (See Pet. 5–9.) Various criteria have been suggested as guides in determining whether or not a distribution in redemption is essentially equivalent to a dividend. See, e. g., *Earle* v. *Woodlaw,* 245 F. 2d 119, 126 (C. A. 9th), certiorari denied, 354 U. S. 942. While taxpayers are correct in pointing out (Pet. 5–8) that a number of courts have described dividend equivalence as a question of fact, these cases necessarily presuppose that under the governing criteria, the fact-finder would be warranted in finding for either party. See, *e. g., United States* v. *Fewell,* 255 F. 2d 496, 499–501 (C. A. 5th). The present case is not in conflict with

[2] There is no basis in the statute or elsewhere for taxpayers' suggestion (Pet. 9–10) that, because stock in a "listed corporation" is more readily saleable than that of an unlisted corporation, a distribution of earnings by the latter which is essentially equivalent to a taxable dividend under Section 115 (g) is to be treated as if it were a sale of the stock resulting in capital gain under Section 117. The provisions of Section 115 (g) apply equally to all corporations, whether or not their shares are listed on an Exchange, and the courts below properly applied the same dividend equivalence test here as is applicable to any corporation.

those decisions because the operative facts here are undisputed, and under any of the recognized criteria for deciding the question, the taxpayers could not prevail.

The undisputed facts show that the redemption produced no significant change in the proportionate stock interest of the shareholders. (Pet. 17.) The distribution was not incident to any business contraction (Pet. 17; R. 39a), nor was there any other business purpose for the distribution. The distribution was admittedly arranged by the executors of the shareholder estate for the sole purpose of obtaining funds to pay the taxes which the estate owed. (Pet. 4.) Despite substantial profits, the corporation had declared no dividends on its common stock during the six-year period prior to this distribution. (Pet. 18; R. 50a–51a.) At the time of the $57,200 distribution, the corporation had earnings or profits of some $657,000. (R. 38a.)

On this set of facts, the District Court was clearly correct in deciding the issue. (R. 73a–88a, 96a–98a.) *Commissioner* v. *Roberts,* 203 F. 2d 304, 306 (C. A. 4th); *Earle* v. *Woodlaw,* 245 F. 2d 119, 126–130 (C. A. 9th), certiorari denied, 354 U. S. 942. See *Ferro* v. *Commissioner,* 242 F. 2d 838, 841–842 (C. A. 3d). Cf. *Keefe* v. *Cote,* 213 F. 2d 651, 656–657 (C. A. 1st); *United States* v. *Fewell,* 255 F. 2d 496, 499–501 (C. A. 5th); *Jones* v. *Griffin,* 216 F. 2d 885, 887, 890 (C. A. 10th). By moving for a directed verdict, as did the Government, taxpayers recognized and claimed that no issue of fact remained for submission to the jury.

3. No claim is or can be made that the courts below failed to apply the judicially established legal stand-

ards for determining the question of dividend equivalence under Section 115 (g) of the 1939 Code. Whether the question be viewed as one of law, or of ultimate fact, or as a mixed question of law and fact, is of academic importance insofar as the disposition of this case is concerned, for the result must be the same under either view.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HARRY BAUM,
GEORGE W. BEATTY,
Attorneys.

OCTOBER 1958.

U. S. GOVERNMENT PRINTING OFFICE: 1958